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## Europe's Next Cold War

The European Union needs a plan to secure its energy supply

By Frank Umbach

**Ensuring Germany's—and Europe's—supply of energy is still viewed largely as an economic issue, not as a matter of foreign and security policy. The gas conflict between Russia and Ukraine has prompted warnings against excessive dependency on Russia. What are the consequences for the security of Germany's energy supply?**



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For years, international energy experts have stressed the increasing strategic importance of supply security among the goals to which economic efficiency and environmental compatibility also belong. But only now, in the aftermath of the winter 2005-2006 gas conflict between Russia and Ukraine, has the future security of German and European energy supplies become the focus of a broad debate. Because the Russian cutbacks in gas deliveries affected EU member states as well as Ukraine, the episode has debunked a number of long-standing assumptions underlying Germany's energy and foreign policies, among them that:

- oil and gas are exclusively economic goods, not strategic ones. According to this view, energy resources are not part of the foreign and security policy strategy of other countries, and the energy policies of other countries strictly adhere to the rules of market economics;
- the security of the energy supply is no longer an important factor and can be left to private utility companies;
- disruptions in regional or global energy supply can be offset by other oil and gas imports at any time;
- Russia under President Putin has steadily strengthened its market orientation;
- never having used energy exports as a political weapon, not even during the cold war, Russia will al-

ways prove to be a reliable energy partner for Europe;

- Russia's need to export its oil and gas to the European market has led to mutual dependence that precludes the instrumentalization of Russian energy and pipeline policy as a factor of foreign policy in the age of globalization.

For many years, these assumptions made it possible to ignore that Moscow has indeed used its energy exports and pipeline monopoly as an instrument of foreign policy to intimidate and blackmail neighboring states—albeit with little success—since the demise of the Soviet Union. Holding more than 25 percent of the world's natural gas and hard coal reserves and 6 percent of the world's oil reserves, Russia has also considerably increased its strategic position in many of the successor states to the USSR and in the new EU member states. It has done so by buying up utility companies, pipelines, refineries and infrastructure through Gazprom and other giant energy corporations and thus expanding its monopoly. Gazprom will seek direct access to customers in the European Union and Germany in order to expand its market share from 26 percent at present to 38 percent by 2020. Russia is striving to build a gas cartel with which it would be able to dictate more than just prices. To date, however, neither Germany nor Europe has engaged in sustained analysis and discussion of how, under these circum-

stances, to liberalize the German and European gas markets, which are in the grip of oligopolies in any case.

Other international economic and political conditions, too, have changed to such a degree that it is useless to look at earlier decades and assert that “everything went well after all.” Until 2004 observers in Germany also overlooked Asian, especially Chinese, energy demand and its implications for Europe’s foreign and energy security policy. Germany did not wake up to reality until its industry experienced mounting difficulty with imports of raw materials because China, India and other states were prepared to pay far more than customary international market prices for them. On March 8, 2005, the Federal Association of German Industry (BDI) held a congress on protecting Germany’s supply of raw materials and energy, its first such event in more than twenty years. Since then, a high-ranking BDI group has been created to address issues connected to international raw materials and to formulate a national strategy.

Given this state of affairs, it is not surprising that the matter of securing Germany’s energy supplies still lies solely in the hands of the ministries of economics and the environment, an arrangement unlike those in other EU member states. However, it means that the expertise existing in the foreign ministry and the defense ministry of foreign countries and global regions has no bearing on overall strategy for shaping policy on energy security.

By contrast, the EU Commission’s 2000 Green Paper on aspects of the European energy supply systematically examined the future of its security. Energy security has also become an integral part of the European Union’s Common Foreign and Secu-

rity Policy (CFSP). It was incorporated into the European security policy of December 2003 and institutionalized as energy dialogs conducted throughout the world. In Germany, this EU policy went almost unnoticed. Instead, the debates on energy policy became ideological disputes between advocates and opponents of nuclear energy and remained exceedingly parochial. Non-economic, particularly geopolitical, factors (such as the political stability of the crude-oil and natural-gas exporters or their interests and motivations) thereby did not figure in the analyses of international energy security. Or forecasts of oil and gas prices made light of them as singular or temporary events, dismissing them as distortions.

In the last two decades, the topic of energy security has effectively been left to private energy companies, whose corporate strategy is, of course, primarily profit driven. Even after the terrorist attacks of September 11, 2001, which generated increasing global discussion about the future political stability of the Middle East as the center of the world’s crude oil supply, the security of supply was not something that greatly occupied Germany. This lack of response is all the more incomprehensible when it is remembered that Germany has declared that it will abandon nuclear energy by 2021 and is thinking of drastically reducing coal extraction for environmental reasons. But improving energy efficiency and conservation and developing renewable energy sources alone will not fully ensure base load electricity production by 2030 that will compensate for phasing out nuclear energy. This outlook will presumably make it necessary to import gas (chiefly from Russia) in quantities even greater than Germany currently does.

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### Why Oil Prices Will Continue to Rise

Unilateralist trends in national energy policies and a penchant for renationalization and state expropriation are spreading worldwide (for example in Russia, Asia and Latin America). This development is calling into question forms of multilateral cooperation and the market-driven orientation. The result is both a global zero-sum game over rights of access to oil and gas fields and a "great game" about pipelines that is by no means confined to Central Asia. As the Russian-Ukrainian contention over natural gas shows, the latter game is being played in Europe as well.

In this context it is worth noting that fossil energy sources (especially oil and gas) will continue to remain the backbone of the global energy system until 2030. They will have to meet up to 90 percent of the global increase in energy demand. Although natural gas is the world's most rapidly growing energy source (2.4 percent annually) and although its extraction is being doubled, oil, which now covers about 37 percent of the world's energy demand, will remain the most important energy source.

Under these circumstances it is short-sighted to exclusively pursue a "market approach" that fails to take domestic and regional conditions into account. For example, the current high price of oil can essentially be explained by four factors (with a terror-related bonus that adds eight to nine dollars):

- the underestimated global demand from Asia (China and India above all);
- the squeeze on surplus global production capacities that can be quickly mobilized in certain countries if oil production is disrupted;
- limited refinery and transport capacities;

- multiple political crises in oil- and gas-exporting states and natural catastrophes that lead to disruptions in production and export, causing global bottlenecks.

Three additional factors are likely to play decisive roles in determining the structure of international energy security in the medium term:

- the concentration of oil and gas reserves in politically unstable countries of the Middle East (with 65 percent of the world's remaining crude oil and 34 percent of the world's remaining natural gas being located in the Persian Gulf alone);
- the gigantic need for investment to preserve the stability of oil and gas supplies throughout the world;
- intensifying trends toward renationalization and state expropriation that diminish efficiency (e.g., by undermining cost consciousness, reducing productivity and exacerbating corruption) and therefore infringe on the global stability of the energy supply.

### The EU Energy Security Policy

Although harking back to the treaty that created the European Coal and Steel Community in 1951, the European Union possesses significant authority only over nuclear energy and, for historical reasons, the coal sector. Given the regional and global interdependencies that influence energy policy, this sphere would seem to be the most natural field for enhanced co-operation. But by and large the community still has no jurisdiction over it—with the exception of the clauses for a fair competition and environmental policies. Energy policy remains a matter of the individual EU member states.

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on imports of crude oil and natural gas in particular is steadily growing. It was therefore with concern that the EU Commission's Green Paper on energy security (November 2000) forecast that the dependence on energy imports will escalate from 50 to 70 percent by 2030. The share of EU energy consumption covered by imports is likely to rise from 76 to 90 percent in the case of oil; from 40 to 70 percent for natural gas; and from 50 to more than 70 percent for coal. The reason is not so much a growing need for energy but rather the dwindling of Europe's own oil and gas reserves in the North Sea.

The worry about energy security is also stated in the EU Commission's November 2005 progress report on the European single market for energy. In June 2005 the Commission had already accepted a new Green Paper on energy efficiency that called for energy consumption to be cost effectively reduced by as much as 20 percent by 2020 through change in consumer behavior and through energy efficient technologies. However, experts are skeptical whether conservation on this scale is realistic.

As with the EU Commission, the foreign ministries of individual EU member states have meanwhile begun to analyze the geopolitical and foreign policy dimensions of ensuring Europe's energy supply in the future. The British Foreign Office, for example, has adopted its own energy strategy. The Netherlands has elaborated an internal statement of principles by its foreign ministry and is seeking to discuss it with the German foreign ministry, which was not conceptually prepared for this crux of German energy, economic, foreign and security policy until the end of 2005. The EU commission, by contrast, has intensified its energy dialogs with

many states and organizations within the frameworks of the CFSP and its own energy foreign policy as well as other contexts. It is also pushing forward with specific energy projects, including some with OPEC and the Gulf states.

#### How Reliable is Russia?

Former German Chancellor Gerhard Schröder is not the only actor to have endorsed a close strategic energy partnership with Russia—so has the European Union. Compared to Germany, though, the European Union has argued for much greater diversification of energy imports, notably those of gas, say, from the Caspian region. Russian natural gas presently accounts for 41 percent of Germany's gas imports and 35 percent of the gas consumption, and those figures are threatening to rise to a level ranging between 60 and 70 percent. The agreed construction of a 1200-kilometer (745-mile) northern European gas pipeline on the bed of the Baltic Sea only heightens the probability of this increase, especially because a second leg of the pipeline is expected to guarantee Germany a total annual volume of 55 billion cubic meters of gas. (Germany currently consumes 95 billion cubic meters of gas per year.) Theoretically, this way Germany could cover approximately 50 percent of its gas consumption and up to 36 percent of its total energy consumption. But the country would be much more vulnerable than it presently is.

This assessment applies not only to the case in which Moscow closes the gas valve but also to conceivable terrorist attacks on the two underwater pipelines, which can cause far greater environmental damage than overland pipelines. With terrorist attacks on pipelines increasing around the world, this aspect of security has not yet been

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adequately weighed either by Gazprom's German gas partners or by German policymakers.

Representatives of German business have hailed the diversification of pipelines as protection of Germany's energy supply for decades through partnership with Russia. But long-term delivery contracts cannot automatically be equated with improving the safety of the country's energy supply. On the contrary, Germany is becoming even more dependent on Russia. And whether German companies will acquire strategic market advantages in the key sectors of the Russian economy as hoped by the chancellor's office under Schröder remains uncertain.

Nor is the northern European gas pipeline an example of a genuinely equal partnership between German gas companies and Gazprom; Gazprom controls 51 percent of the organization. Routing the gas pipeline through the Baltic Sea and thereby avoiding transit through Ukraine, the Baltic countries and Poland, a proposal that is two to three times more expensive than a land-based pipeline, came from Gazprom and the Kremlin and is based primarily on geopolitical considerations. German politicians who welcome the Baltic Sea pipeline yet criticize the high gas prices in Germany do not realize that such pipeline projects and the long-term delivery contracts between German gas companies and Gazprom are also dubious on economic grounds, since there are more favorable alternatives. There is no recognition of the connection between the liberalization of the gas market in Germany and the European Union; the monopoly that Gazprom has on the market; and the troubling dependence at the expense of the consumer, the German econo-

my, and, ultimately, the future security of supply. The proposal by German Chancellor Angela Merkel that Poland and the Baltic countries be brought into the pipeline project can indeed be thought of as a litmus test for Russian pipeline policies, since it is diametrically opposed to Moscow's geopolitical objectives. Hardly surprising, no progress on it has been made. Rather, it is a symbol for the lack of a common EU energy policy.

### Moscow's "Energy Imperialism"

Moscow has subtly and sometimes not so subtly exploited both the power it derives from its raw materials and the energy dependence of its neighboring states in eastern Europe and the Caspian region as an instrument of foreign policy and security policy. It is thus fundamentally problematic for Germany and the European Union to become heavily dependent on imports of Russian gas, especially since attempts at renationalization have become apparent in the Russian parliament and the Kremlin since the beginning of the Putin era. These stirrings have been largely ignored thus far, but the doctoral thesis by Putin in 1997 and an article of his in 1999 communicated his understanding of what the Russian resource sector means for the state and for foreign policy. Having called the disintegration of the Soviet Union the "greatest catastrophe of the twentieth century," Putin sees this "strategic sector" not only as a key to economic renaissance but also or even primarily as an instrument of Russia's geopolitical reascendancy as a future superpower in energy.

Although foreign companies are now able to increase their stake in Russian companies, the only role open to them is that of junior partner. Moreover, Russia has now passed

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legislation that curbs the rights of foreign investors still further, permitting only companies registered in Russia to participate in state auctions of extraction licenses.

The European Commission and the International Energy Agency have not been the only actors in recent years to warn Germany against inordinate dependence on Russia for energy; the governments of Great Britain and France have done the same. Although the European Union and Germany have no real alternative to a strategic partnership with Russia in energy matters, they do not have to make themselves so dependent. As shown by the failure to ratify the European Energy Charter and the transit treaty, the interests of the two sides are anything but compatible at the moment. A naïve and uncritical attitude on Germany's part is counterproductive, not only because it shackles foreign policy ("silence for gas") but also because it does nothing to support reformers of domestic policy who are working to align Moscow's energy policy with market economics.

#### The Russian-Ukrainian Gas Conflict

The fivefold upward adjustment of gas prices for Ukraine confirms that foreign policy is behind the Kremlin's pricing policy, which rewards allies and punishes renegades by means of a graduated price system. In August 2005 Russia's foreign minister indicated a radical shift in policy on energy prices, saying in an interview that the Kremlin would no longer tolerate any agreement with neighboring states and EU member states unless Moscow economically and politically benefited from granting discount prices. In that sense, raising the price of Russian gas to world levels for Ukraine was merely a pretext.

Moreover, Moscow is keen on buying up the Ukrainian pipelines and has tried to influence the Ukrainian parliamentary elections in March 2006. Just recently Moscow was able to bolster its political market power over Europe's energy supply by taking over control of the Belarusian section of the Yamal natural gas pipeline.

The simultaneous reprimand that Kiev was threatening European supply security by illegally siphoning off gas and fomenting political confrontation with Moscow (about 80 percent of Russia's gas deliveries to Europe run through Ukraine) served the objective of lending additional legitimacy to the Baltic Sea pipeline. The fact that representatives of Germany's gas utility companies accepted the Russian propaganda uncritically was hardly surprising. The EU Commission's reticent response was less understandable. Like the new German federal government, it treated the gas conflict at first as an energy issue rather than as a problem concerning foreign policy. Although hectic diplomacy to settle the dispute did take place behind the scenes, the Commission came across as politically helpless. Brussels had evidently assumed an EU-Russia energy partnership based on quite different conditions.

By closing the Russian gas valve, Moscow demonstrated its increasing willingness to instrumentalize its energy-related power for foreign policy ends as well. For Europe, the United States and the World Trade Organization, that act makes Russian energy policy not only a challenge to economic policy but also a problem for foreign policy. Neither the EU nor Germany is prepared for this kind of conflict. Nonetheless, there are certainly lessons for the future security of Europe's energy supply.

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### Lessons for Germany

The security of Germany's energy supply and its vulnerability because of dependence on Russian natural gas did not land on the political agenda until the gas conflict between Russia and Ukraine put it there. German policymakers owe the Russian president thanks for this service. Without it, the German discussions about energy security would probably be confined exclusively to climate protection and economic efficiency for another ten years. But the political fallout stems less from the future scarcity of available energy resources than from their concentration in only a few regions, above all those that are usually politically unstable.

The criticism that the international energy organizations, the European Union, and individual EU member states have leveled at Germany's excessive dependence on imports of Russian gas is something that Germany should take seriously. What is often perceived abroad to be a neo-Wilhelmine energy policy—Germany as the world's elixir—clashes with the picture of Germany's economic decline and calls for critical self-examination. The stance Germany has taken on energy in recent years has probably been the country's policy area least compatible with that of the European Union. This mismatch is attributable to more than just the enduring ideological obsession with abandoning nuclear energy, an attitude even less able to attract majority support in the European Union today than in the past. Germany has overlooked the fact that the EU Commission has seen energy security as an integral part of CFSP since 2001. For that reason neither Germany nor the European Union can leave the security of supply mainly or solely to private industry.

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When considering the question of Russia's reliability, the proponents of mutual dependence between Germany and the European Union on the one hand and Russia on the other overlook a key difference between the present and the era of the Soviet Union. In those days gas exports to western Europe were mostly of great economic importance to the Soviet "colossus on clay feet." Today Putin sees gas exports essentially as a vehicle of foreign policy and of Russia's reemergence as a superpower that acts in a more modern fashion by wielding monopolistic power over the market to discipline renegades and demand respect for Russian interests. From these viewpoints of both domestic and foreign policy, Russia's reliability as Germany's energy partner is extremely dubious.

These considerations lead to several conclusions for German energy security:

- European and global supply security must receive much more attention than in the past. The intention of elaborating "an overall national energy policy concept" is therefore welcome. However, to enhance the compatibility between the concepts contributed by the EU Commission and those advanced by important EU member states, including Germany, this work must also draw on the expertise that Germany's foreign ministry and the defense ministry have in foreign policy, security policy and the individual foreign countries. It is therefore not enough to leave the preliminary work entirely to the ministries of economics and of the environment as is currently the case. To ensure that conceptualization of this kind has input from the various portfolios, it should be guided by the federal chancellor's office and an institutionalized fed-



- eral (or national) security council.
- It is time for a common European energy policy, as called for by Tony Blair before the European Parliament in October 2005.
  - The recent altercation over gas shows the necessity of achieving a balanced mix of energy sources that not only provides for development of renewable energies and increases energy efficiency but also extends the remaining life of nuclear power plants and retains domestic coal production until at least 2030.
  - At best, the planned Baltic Sea pipeline will improve Germany's supply security in a purely technical sense. Otto Graf Lambsdorff is therefore correct in calling for a renegotiation of the pipeline so as to bring in Poland and the Baltic states—though it seems unrealistic.
  - The German gas industry, too, should critically reconsider its corporate strategy of relying primarily on a strategic alliance with Russia, for it could prove to be economically shortsighted as well. To a certain degree there is no alternative to an energy partnership with Russia and Gazprom, but it should be expanded into a truly equal partnership. The purported interdependence of the two countries is a myth. The German gas industry is well advised to increase the diversification of its imports in order to spread the business risks.
  - The German gas industry should press forward with the option of liquid gas imports by building a suitable terminal in the North Sea port city of Wilhelmshaven. The gas companies should also accept the invitation to join the Nabucco project, which provides for the construction of a gas pipeline running from Turkey through Bulgaria, Romania, and Hungary. Policymakers and the business community should realize that Germany has a relatively advantageous geographic location for importing gas from all directions.